

**STATE OF NEW JERSEY**

***Board of Public Utilities***

*Two Gateway Center  
Newark, NJ 07102*

TELECOMMUNICATIONS

IN THE MATTER OF THE APPLICATION	)	
OF VERIZON NEW JERSEY INC. FOR	)	
APPROVAL (i) OF A NEW PLAN FOR AN	)	<u>ORDER ACKNOWLEDGING</u>
ALTERNATIVE FORM OF REGULATION	)	<u>RECEIPT OF REPORT</u>
AND (ii) TO RECLASSIFY MULTI-LINE	)	
RATE REGULATED BUSINESS SERVICES	)	
AS COMPETITIVE SERVICES, AND	)	
COMPLIANCE FILING	)	DOCKET NO. TO01020095

(SERVICE LIST ATTACHED)

BY THE BOARD:

BACKGROUND

At its agenda meeting on May 8, 2001, the Board of Public Utilities (Board) directed Staff to prepare a Request for Proposal (RFP) to obtain the services of a consulting firm to perform a comprehensive review of the financial integrity of Verizon New Jersey Inc. (VNJ) pursuant to the Board's December 22, 2000 Order in I/M/O the Application of Bell Atlantic-New Jersey, Inc. for Approval of a Modified Plan for an Alternative Form of Regulation and to Reclassify all Rate Regulated Services as Competitive Services and I/M/O the Application of Verizon New Jersey Inc. for Approval of an Extension of Its Plan for an Alternative Form of Regulation, Docket Nos. TO99120934, TO92030358 and TO00120955 (December 22, 2000 Order). The intent of the review was to provide the Board with an assessment of the financial integrity of VNJ in order to assist the Board in evaluating VNJ's proposal for approval of a modified plan for an Alternative Form of Regulation (Proposed Plan) in this Docket, and to quantify the savings, if any, resulting from the mergers of Bell Atlantic Corporation (BA) with NYNEX Corporation (NYNEX) and GTE Corporation (GTE). See the December 22, 2000 Order at 6-7. The results of the review were also to be used to determine if VNJ's practices with respect to the areas of financial reporting, merger costs and savings and affiliate costs comply with applicable law, Board rules, Board Orders and procedures. To the extent that areas of non-compliance are identified, the consultant's report will enable the Board to direct any necessary remedial efforts to bring VNJ into compliance.

On May 8, 2001, an RFP was mailed to 57 prospective consulting firms, and was posted on the Board's website. This mailing followed Staff contact with the New Jersey Commerce and Economic Development Office of Small, Women and Minority Businesses in order to seek out all qualified firms. On June 1, 2001, six proposals were received and were evaluated by Staff

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from the Divisions of Telecommunications and Audits. On June 20, 2001, the Board selected Liberty Consulting Group (Liberty) to perform the review at a cost not to exceed \$407,120, with costs to be borne by VNJ.

## REVIEW PROCESS

The review commenced on June 21, 2001 and continued through to September 20, 2001. The scope of the review was broken down into three major areas of focus: (1) Financial Evaluation; (2) Merger Costs and Savings; and (3) Affiliate Costs. Liberty submitted a total of 247 data requests and conducted 33 interviews. In the area of Financial Evaluation, the areas of review included VNJ's analysis of earnings filed in the proposed plan proceedings, SEC 10K Annual Reports, Surveillance Reports to the Board, Investment Analysis, Bond ratings, pre and post-tax interest coverage and dividend policy, etc. In the Merger Costs and Savings area, Liberty reviewed VNJ's quantification of savings and costs resulting from the 1997 BA/NYNEX merger and the 2000 BA/GTE merger. Liberty considered the appropriateness and reasonableness of merger cost and savings allocations to VNJ, and the reasonableness of the assumptions and data underlying VNJ's merger cost and savings estimates. In the area of Affiliate Costs, Liberty examined the methods for allocating affiliate costs, the reasonableness of allocated affiliate costs and compliance with applicable allocation rules on costs and revenues.

In conforming to the time schedule for the review, Liberty submitted a draft report to Board Staff on September 20, 2001 even though there were approximately 13 data requests still outstanding. VNJ was also given a copy of the draft report. VNJ submitted its comments on the draft report to both Staff and Liberty on October 3, 2001. After Liberty received answers to the outstanding data requests from VNJ, it replied to VNJ's comments on the draft report. Liberty then submitted a final draft report on October 12, 2001 to Board Staff and to VNJ. Liberty then incorporated any factual clarification and editorial changes to the final draft report that were recommended by Staff or VNJ, and that Liberty deemed appropriate, and then submitted a revised final report to the Board on October 23, 2001.

## REVIEW RESULTS

Liberty submitted a total of 20 findings and conclusions and 11 recommendations for the three review areas. Set forth below is a summary of the major recommendations and findings for the three key areas:

Financial Evaluation: Liberty found that VNJ is financially healthy and its dividend policy has effectively protected New Jersey capital expenditure funding and facilitated VNJ capital management. Liberty recommended that VNJ:

- (1) update its dividend policy to reflect current rating practices. (Recommendation No. II-3).
- (2) provide the Board additional information on whether the investment in and maintenance of the New Jersey network is adequate, and do so in a way that is more timely than the present service quality indicator reports. (Recommendation No. II-1).

Merger Costs and Savings: Liberty found that the estimates of savings for the BA/NYNEX merger appear reasonable, but found that the lack of clarity for the basis of the BA/GTE merger savings and the dependence on aggregate allocations make those estimates unreliable as a basis for appraising the results of that merger. Liberty recommended that VNJ file a more detailed report on the BA/GTE merger benefits with the Board. (Recommendation No. III-1).

Liberty also found that VNJ's tracking and reporting to the Board of merger savings and costs are deficient, and recommended that VNJ correct and improve its deficient reporting of merger costs and savings. (Recommendation No. III-3).

Affiliate Transactions: Although Liberty found that VNJ cost allocation processes perform in an acceptable manner, Liberty suggested that VNJ strengthen the service company cost allocation process and increase service company departments' involvement in it. (Recommendation No. IV-1). Liberty also recommended that VNJ management be more involved in monitoring and controlling affiliate transactions in their company. (Recommendation No. IV-2).

## DISCUSSION AND FINDINGS

Having reviewed Liberty's revised final report, the prior draft reports, the comments by VNJ and the reply comments by Liberty, the Board FINDS that Liberty has successfully fulfilled its responsibilities to review and report on VNJ's financial integrity. Therefore, the Board HEREBY ACKNOWLEDGES RECEIPT of the final report of Liberty. The Board DIRECTS that the final report be placed into the record in this proceeding and AUTHORIZES the release of the final report to the parties in this proceeding. This report shall also be made available to the public at the Board's Newark office for the customary duplication fees. The Board also DIRECTS that Staff release the 20 percent holdback of professional fees to Liberty Consulting. Having placed the final report into the record in this proceeding, the Board shall permit discovery upon Liberty for a period of seven (7) days from the date of receipt of this Order, and DIRECTS Liberty to respond to such discovery requests within seven (7) days thereafter.

Finally, The Board DIRECTS Liberty to make a witness available for cross-examination on all aspects of the final report on November 26, 2001.

DATED: November 9, 2001

BOARD OF PUBLIC UTILITIES  
BY:

(Signed)

CONNIE O. HUGHES  
PRESIDENT

(Signed)

FREDERICK F. BUTLER  
COMMISSIONER

(Signed)

CAROL J. MURPHY  
COMMISSIONER

ATTEST:

(Signed)

FRANCES L. SMITH  
BOARD SECRETARY